Postal Regulatory Commission
Submitted 11/7/2011 4:20:20 PM
Filing ID: 77489
Accepted 11/7/2011

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

	)	
Notice of Market Dominant	)	Docket No. R2012-3
Price Adjustment	)	

VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC. COMMENTS ON THE UNITED STATES POSTAL SERVICE NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT
(November 7, 2011)

On October 18, 2011, the U.S. Postal Service filed a Notice of Market-Dominant Price Adjustment ("Notice") with the Postal Regulatory Commission pursuant to the Postal Accountability and Enhancement Act ("PAEA"), Public Law 109-435 (*see* 39 U.S.C. § 3622), and the Commission's rules promulgated thereunder (*see* 39 C.F.R. §§ 3010.1, *et seq.*). The Postal Service states that the price adjustments, all within the **2.133 percent** price cap, will take effect on **January 22, 2012**.

The Commission issued Order No. 921 on October 21, 2011, opening this docket and setting November 7, 2011 as the deadline for public comment. These comments are filed jointly on behalf of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (hereinafter "Valpak"). Under Rule 3010.13(b), these comments focus on compliance of noticed prices with the requirements and policies of Title 39.

I. THE POSTAL SERVICE'S NOTICED PRICES FOR STANDARD MAIL IGNORE THE FINANCIAL REALITIES OF THE MARKETPLACE.

A. The Postal Service Has No Money of Its Own.

The Postal Service no longer receives **taxpayer support**, and it has no **retained earnings**. **Revenue from mailers** constitute virtually all of the Postal Service's revenues. When the Postal Service engages in wasteful expenditures, the revenue to pay these expenses comes from higher prices charged to mailers. Likewise, when it **underprices products**, thereby losing money, the revenue to make up the losses comes from higher prices charged to other mailers. With no retained earnings, it has no money of its own that it can use to subsidize deliberate underwater pricing.

B. The Postal Service's Standard Mail Pricing Fails to Address the Problem of Losses from Underwater Flats.

The Postal Service's cap for Standard Mail is 2.133 percent, and the Postal Service proposes to use 2.124 percent of that authority. Notice, pp. 4-5. The Standard Mail pricing's Percent Changes, by Product, are as follows:

Table I-1

Standard Mail Product Price Changes

Standard Mail Product	Price Change (%)
Standard Letters	1.867
Standard Flats	2.209
Standard Parcels/NFMs	2.864
HD/Sat Letters	2.298
HD/Sat Flats and Parcels	2.878
Carrier Route	2.425

Source: Notice, p. 18.

As of the last Annual Compliance Review, Standard Flats and Standard Parcels & NFMs were both deeply underwater. *See*, FY 2010 Annual Compliance Determination ("ACD"), p. 102. Since then, Standard Parcels & NFMs received a large increase. Yet, the Postal Service has now proposed for Standard Flats an average rate increase, similar to that for all other Standard Mail products.

Since product costs for FY 2011 are not now available, it is impossible to know exactly what coverages will result from the Postal Service's noticed rates. However, Table I-2 provides some indication of relative changes in coverage.

Table I-2

Potential Changes in Standard Mail Coverage
(estimated, using FY 2010 costs)

Standard Mail Product	FY 2010 (%) (1)	4/17/11 Increase (%) (2)	Effect on Coverage (3)	Noticed Increase (%) (4)	Effect on Coverage (5)
Letters	181.3	1.810	184.6	1.867	188.0
Flats	81.8	1.835	83.6	2.209	84.3
Parcels & NFMs	77.9	11.346	86.7	2.864	89.2
HD/Sat Ltrs	212.8	0.615	214.1	2.298	219.0
HD/Sat Flats & P.	224.4	0.403	225.3	2.878	231.8
Carrier Route	143.0	1.376	145.0	2.425	148.5

Since prices are increased while costs are held constant, all coverages demonstrate increases. Only relative changes in prices are significant, and there are no meaningful changes. That means deeply underwater products can be expected to remain deeply underwater, and products which pay high coverages continue to pay high coverages; *see* Table I-2, columns 1, 3 and 5.

Although elasticity estimates are not available by product, they are available for what were Standard Regular and Standard Enhanced Carrier Route ("ECR") subclasses.[1] ECR best correlates to the High Density/Saturation Letter and High Density/Saturation Flat products. The last reported elasticity for Standard Regular was -0.286 percent, and for ECR, -0.727. Contrary to normal pricing principles, under the Postal Service's noticed pricing, the High Density/Saturation products with elasticities over two and a half times that of other products continue to pay coverages much higher than low-elasticity Standard Mail products. In Docket No. ACR2010, the Commission described this type of inverted pricing as being addressed by below average increases for Saturation mailers. FY 2010 ACD, p. 108. There is no below average increase for Saturation mailers proposed in this docket.

C. Without Sound Business Judgment, Pricing Flexibility Can Be Dangerous to the Postal Service's Financial Health.

It is true that 39 U.S.C. section 3622(b)(4) supports Postal Service **pricing flexibility**. Pricing flexibility involves the application of judgment to markups over attributable cost. Such markups are the way that the Postal Service, hopefully, will be able to recoup all of its unattributed overhead costs.[2] What the Postal Service seemingly fails to recognize is that **when a product does not cover the costs** which it causes the Postal Service to incur solely for

---

[1] *See* Market Dominant Products: USPS Demand Equation Estimation and Volume Forecasting Methodologies (Jan. 20, 2011).

[2] If all unattributed overhead costs cannot be recouped from such markups, the Postal Service will need to either reduce further its "fixed" overhead costs such as headquarters staff, or reduce operating costs considered part of its universal service obligation (*e.g.*, go to three-day-a-week delivery), or seek an annual taxpayer-provided appropriation from Congress.

the benefit of that product, there should be **no room for judgment, and no flexibility**. Price-setting flexibility applies **only to markup over attributable cost**.

Recently, the Postal Service did use its pricing flexibility to increase substantially the price of **Standard Mail Parcels & NFMs**, which product also was deeply underwater; *see* Table I-2, col. 2. The Postal Service justified the **11.346 percent** price increase by explaining that "Standard Mail parcel prices increase at above average rates to move them closer to covering their costs." Docket No. R2011-2, Postal Service Notice, p. 18. The higher price took effect on April 17, 2011. Contrary to expectations, the volume of Standard Mail Parcels & NFMs did not decline dramatically. In fact, **volume seems to have increased**, at least in the short period since the price increase went into effect. In 2010, the volume of Standard Mail Parcels & NFMs was 166,083 in Q3 (April 1 to June 30), and in Q3 of 2011, with the higher price in effect for almost 11 of the 13 weeks, volume increased to 177,228. *See* FY 2011, Quarter 3, Revenue, Pieces, and Weight Report, http://www.prc.gov/Docs/74/74925/Fy2011q3_RPW summaryreport_public.xls.

D. Pricing Policy Appropriate for Standard Mail.

The centerpiece of the Postal Service's pricing for Standard Mail appears to be maintaining the enormous subsidy for certain catalog mailers, at the expense of all other users of Standard Mail. The Postal Service's flawed pricing of Standard Flats led to the Commission's finding in its FY 2010 ACD that rates for Standard Flats were in violation of PAEA (discussed in Section II, *infra*).

Once the decision was made to maintain the subsidy for Standard Flats, the next decision was to determine which other Standard mailers should be required to pay more in order to support the subsidy to Standard Flats. Most users of other Standard Mail products already paying a very high cost coverage[3] are again being called upon to pay still higher rates and an even higher cost coverage than necessary in order to provide the Postal Service with additional revenue, part of which will go to subsidize continuing losses from underwater products such as Standard Flats. Needlessly allowing such subsidization to continue is neither fair nor equitable and does not constitute a responsible use of rate flexibility. Neither "rate flexibility" nor "informed judgment" should be considered an acceptable rationale for designing intentional losses into the price structure and forcing subsidization by other mailers.

The Postal Service should have used much of its cap authority for Standard Mail for an increase in the price of Standard Flats[4] to reduce significantly the extensive losses that are being incurred — and passed on to other mailers — to support this badly underwater product as discussed in Section II, *infra*. Indeed, it is likely that giving proper pricing signals would result in the transition of Standard Flat catalogs to letter-shaped catalogs. The worst that can happen is that the Postal Service will see a decrease in some money-losing volume. Additionally, such a pricing decision would allow the Postal Service to give no (or little)

---

[3] In FY 2010, the **cost coverage** for High Density & Saturation Flats and Parcels was **224.4 percent**, and the cost coverage for High Density & Saturation Letters was **212.8 percent**. *See* Annual Compliance Determination 2010, p. 102.

[4] It appears that the business plan of many catalog companies heretofore has depended critically upon:

(i) highly subsidized postage rates, and
(ii) largely enabling consumers to avoid state and local sales taxes which competing retail stores are required to collect.

The proper policy approach for the Postal Service is to provide accurate price signals — a level playing field — and to let fair competition occur. This means that catalogers should pay their way, just like other mailers and brick-and-mortar retail establishments do.

increase for any other Standard Mail product — which should help maintain, and perhaps even help grow, the volume of those other highly profitable products, such as saturation mail which now pays prices more than twice its costs.

II. THE POSTAL SERVICE'S NOTICED STANDARD MAIL PRICES VIOLATE THE COMMISSION'S ORDER IN ITS FY 2010 ANNUAL COMPLIANCE DETERMINATION.

A. This Market Dominant Price Adjustment Presents a New Issue.

In a typical market dominant price adjustment docket, *i.e.*, a Type 1-A rate adjustment filing, the Postal Service files a notice with the Commission, and the Commission conducts a reasonably narrow review, primarily to determine (i) whether the new prices are within the Postal Service's pricing authority under 39 U.S.C. section 3622(d), (ii) whether the workshare discounts comply with 39 U.S.C. section 3622(e), and (iii) whether preferred rates comply with 39 U.S.C. sections 3626, 3627, and 3629. Other findings made in the context of a price adjustment case are "provisional and subject to subsequent review."[5] 39 C.F.R. § 3010.13(j).

With respect to Standard Mail, however, this is not a typical market dominant price adjustment docket. The reason for the difference is that in the Commission's most recent Annual Compliance Determination for FY 2010, the Commission made its first finding of noncompliance under 39 U.S.C. section 3653 and ordered the Postal Service to make certain

---

[5] While the Postal Reorganization Act of 1971 required Commission review of Postal Service proposed prices pre-implementation, in 2006 PAEA adopted a full review of rates on an "after-the-fact" basis. This after-the-fact review is accomplished in the context of an Annual Compliance Report submitted by the Postal Service (39 U.S.C. § 3652) and reviewed by the Commission, which then can make a determination of noncompliance (39 U.S.C. § 3653).

adjustments to the rates for Standard Flats to begin to bring them to lawful levels pursuant to section 3662(c). FY 2010 ACD, pp. 106-107. In the proposed rates, the Postal Service has violated this order, requiring the Commission now to go beyond its normal type of review, and respond to the Postal Service's non-compliance with the Commission's order.[6]

B. The Commission Expressly Directed Above-Average Pricing Increases for Standard Flats in its FY 2010 Annual Compliance Determination.

On March 29, 2011, the Commission issued its FY 2010 ACD, finding, among other things, "rates for a market dominant product, Standard Mail Flats, not in compliance with the statute."[7] Specifically, the Commission found that Standard Flats lost $1.4 billion from FY 2008 through FY 2010, losing $557 million in FY 2010 alone:

> the Postal Service has failed to utilize the pricing flexibility granted to it by the PAEA to address this issue, and the negative contribution per piece continues to grow. Furthermore, the recently approved price changes are unlikely to improve cost

---

[6] The Commission might prefer to postpone remedial action until its Annual Compliance Determination for FY 2011, as such postponement would result in a delay of only a few weeks (the Postal Service's Annual Compliance Report being due by December 29, 2011). However, postponing remedial action until that docket would create a situation where there could be two Standard Mail price adjustments within relatively quick succession: the present one scheduled to go into effect on January 22, 2011, followed by another one emanating from the FY 2011 ACD. It is submitted that it would be more efficient and less burdensome on the mailing community if the Commission addressed this problem at one time, in line with PAEA's objective of achieving "predictability and stability in rates." 39 U.S.C. § 3622(b)(2).

[7] The Commission is required, after "a timely written determination of noncompliance," to "take appropriate action in accordance with subsections (c) and (e) of section 3662." 39 U.S.C. § 3653(c). Section 3662(c) requires the Commission to order the Postal Service to "take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as ordering unlawful rates to be adjusted to lawful levels [or] ordering the Postal Service to discontinue providing loss-making products....)."

> coverage. For these reasons, the Commission finds that the **prices** in effect in FY 2010 **for Standard Flats do not comply** with section 101(d) of title 39. [*Id.*, p. 106 (emphasis added).]

The Commission then entered a remedial order:

> Pursuant to section 3653(c), the Commission **directs** the Postal Service to increase the cost coverage of the Standard Mail Flats product through a combination of **above-average price adjustments**, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs. [ACD, p. 106 (emphasis added).]

The Commission was clear as to when remedial action should begin — *i.e.*, in this docket:

> In requiring the Postal Service to take remedial action, the Commission does not impose a specific deadline. However the Postal Service should move as promptly as practicable to eliminate this inequity. This process **must begin with the next market dominant price adjustment**. The Commission finds that, starting with the next Notice of Market Dominant Price Adjustment, the Postal Service **must begin the process of transitioning Standard Flats prices to full cost coverage.**
>
> Within 90 days of the issuance of the FY 2010 ACD, the Postal Service shall present a **schedule of future above-CPI prices increases** for Standard Mail Flats. This schedule shall be updated with each subsequent Market Dominant Price Adjustment and ACR until the revenue of the Flats product exceeds its attributable costs.
>
> * * *
>
> In **subsequent Notices of Market Dominant Price Adjustments**, the Postal Service shall report the following information:
>
> - an explanation of how the proposed prices will move the Flats cost coverage toward 100 percent, and
> - a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats product.
>
> [FY 2010 ACD, p. 107 (emphasis added).]

C. Developments after the FY 2010 ACD Have Not Diminished the Postal Service's Obligation to Comply with the Commission's Directive.

On April 27, 2011, the Postal Service filed a petition for review in the U.S. Court of Appeals for the D.C. Circuit pursuant 39 U.S.C. section 3663, appealing the findings and orders in the ACD relating to Standard Mail Flats.[8]

On May 17, 2011, the Postal Service sought a stay from the Commission of the order requiring a schedule of above-CPI price increases for Flats, pending the outcome of the petition for review.[9] That Motion distinguished the **general** remedial action (increasing the Flats cost coverage) with the **specific** remedial action (filing the schedule of above-CPI price increase), then clearly requested a stay only of the portion of the ACD "in which the Postal Service is directed to take **specific** remedial action." (Emphasis added.)

On May 27, 2011, the Commission granted the relief requested relating to the filing of a schedule (Order No. 739), but expressly noted that "The Postal Service Motion **does not request a stay of the general remedial action** regarding the Standard Mail Flats product described in the 2010 ACD." Further, the Commission stated, "In reaching this conclusion, **the Commission** emphasizes that it **remains committed** to Standard Mail rates that conform with 39 U.S.C. 101(d), and disagrees with Valpak's suggestion that a grant of the Postal

---

[8] This case is now pending, with briefing to conclude on December 21, 2011, and no date for oral argument currently scheduled.

[9] Motion of the United States Postal Service Requesting Stay of the Remedial Provisions Regarding Standard Flats Set Forth in the FY 2010 Annual Compliance Determination (May 17, 2011). Rule 18 of the Federal Rules of Appellate Procedure requires a party seeking a stay ordinarily to move for such stay before the agency whose decision is being reviewed.

Service motion will 'likely … result' in postponement of the achievement of this goal." Order No. 739, p. 2 (emphasis added). Therefore, the Commission's stay is **not** applicable to the Postal Service's present Notice.

D. The Postal Service's Noticed Increase for Standard Mail Flats Recognizes, and then Disregards, the Commission's Order.

The Postal Service Notice recognizes the ACD's order to the Postal Service on Standard Mail pricing, but chooses not to follow it:

> In the FY 2010 ACD, the **Commission directed** the Postal Service "to increase the cost coverage of the Standard Mail Flats product through a combination of **above-average price adjustments**, consistent with the price cap requirements, and cost reductions **until such time that the revenues for this product exceed attributable costs**." **The Postal Service remains concerned** about the financial health and long-term viability of the catalog industry, a major user of the Flats product, and so the **Postal Service has used its pricing flexibility to keep Flats price increases moderate** (objectives 2, 4, factors 3, 7), even though the product's price increase is slightly above the cap (objective 5, factor 2). This approach reflects ongoing concern that the condition of the catalog industry and the economy generally suggest that substantially larger than average Flats price increases **may** result in volume declines that may undermine the viability of this product. In addition, potential operational changes, including network optimization, could substantially reduce operating expenditures. Thus, a balanced approach of moderate price increases in conjunction with cost saving will, over time, begin to address the cost challenges faced by this product. [Notice, pp. 18-19 (emphasis added).]

The Postal Service's increase for Flats in its Notice is **2.209 percent**, ever so slightly above both (i) the calculated cap of 2.133 percent and (ii) the Standard Mail Class average of 2.124 percent. Although one could anticipate the argument that the Postal Service has technically complied with the exact requirement of the Commission's order — "above-average adjustments" — that type of argument would have appeal only to a lawyer. Clearly, the Commission's Order was to achieve rates above attributable costs within a reasonable time frame ("as promptly as practical," FY 2010 ACD, p. 107). At the rate the Postal Service has moved, a positive cost coverage would not be achieved in the lifetime of anyone now working for the Postal Service. Technical compliance must be distinguished from actual compliance. Moreover, of the six Standard Mail products, Standard Flats received the second lowest price increase.

The Postal Service never even attempted to defend its increase for Standard Flats as being in compliance with "the process of transitioning Standard Flats prices to full cost coverage." FY 2010 ACD, p. 107. Instead, it repeated its shopworn rationalizations (termed "concerns") as to why it seeks to continue the subsidy to Standard Flats essentially unabated — arguments that were rejected by the Commission in the last ACD, page 106.[10]

Further, the Postal Service made no effort to comply with the Commission's further order to report "in subsequent Notices of Market Dominant Price Adjustments": (i) "an explanation of how the proposed prices will move the Flats cost coverage toward 100 percent"

---

[10] In defense of keeping Flats prices "moderate," despite the Commission's order, the Postal Service cites objectives 2 ("to create predictability and stability in rates") and 4 ("to allow the Postal Service pricing flexibility"), and factors 3 ("the effect of rate increases upon the general public, business mail users...") and 7 ("the importance of pricing flexibility to encourage increased mail volume and operational efficiency"). The time is past for the Postal Service to attempt to make a case for underwater rates for Standard Flats — these arguments having been rejected by the Commission. The Postal Service's recital of various objectives and factors in no way relieves the Postal Service of its responsibility to comply with the Commission's lawful order.

and (ii) "a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats product." FY 2010 ACD, p. 107. Instead, the description of the Flats price adjustment focuses on why it moderated any adjustment. It argues that these moderate price adjustments combined with unidentified cost savings "will, over time, begin to address the cost challenges faced by this product." Notice, p. 19.[11] This noncompliance with the Commission's order justifies the Commission's rejection of the Postal Service's proposed prices for Standard Flats.

E. The Commission Should Order the Postal Service to Impose Much of the Increase Permitted by the Cap for Standard Mail on Standard Flats.

The Commission should reject the noticed prices for Standard Flats as not being compliant with its order in the FY 2010 ACD. As this is a violation of a prior Commission order issued pursuant to 39 U.S.C. section 3662(c), the Commission is not bound by the limitations for rejecting a price adjustment under section 3622(d)(1)(C)(ii). Since the Postal Service has not made good faith compliance, it is urged that the Commission order new Standard Mail rates which give an increase to Standard Flats in the range of the 11.346 percent increase the Postal Service believed appropriate to impose on underwater Standard Parcels & NFMs on April 17, 2011. This would have the effect of moving Standard Flats toward 100 percent cost coverage in annual steps. This also would allow for a reduction of rates and

---

[11] In prior years, the Commission adopted the Postal Service's approach of allowing moderate price increases combined with cost savings, but finally determined in Docket No. ACR2010 that this approach was inadequate to maintain compliance with PAEA. The ACD even cited the Postal Service's own statement (in its "Flats Strategy" from Docket No. R2010-4) that — even with cost cutting — above-CPI increases will be necessary. The Postal Service's explanations in its Notice cannot be considered as any form of compliance with the ACD because they previously were rejected by the Commission.

coverages[12] for all other Standard Mail products. There is no way to know if a relatively large increase on Standard Flats would significantly affect its volume, but the 11.346 percent increase on Standard Parcels & NFMs actually was followed by an increase, not a loss, in volume.[13] However, even if this price change resulted in fewer pieces being sent as Standard Flats, then the Postal Service losses can be expected to be reduced, perhaps by a substantial amount. Placing a significant increase on Standard Flats would allow reductions in increases being proposed for High Density & Saturation Flats and Parcels and High Density & Saturation Letters and help the Postal Service avoid adverse volume effects that could be expected from price increases on these products which have an elasticity over two and a half times as high as other Standard Mail. This would help attract additional volume to these two products within Standard Mail with the highest coverage and the greatest opportunity to provide additional contribution for the Postal Service.

III. THE POSTAL SERVICE PRICING FOR PRODUCTS USED BY FLAT CATALOGS HELPS ONLY SOME CATALOG MAILERS, AND HARMS OTHER CATALOG MAILERS, AS WELL AS MAILERS USING STANDARD LETTERS AND SATURATION MAIL, WHILE NOT IMPROVING THE FINANCIAL STABILITY FOR THE POSTAL SERVICE.

The Postal Service recently explained how it views its pricing objective:

> It is a matter of public record that the Postal Service is in the midst of a financial crisis and has been for several years.... The **Postal Service's goal** at this time in its history **must be to**

---

[12] 224 percent and 213 percent, respectively. *See* FY 2010 ACD, p. 102.

[13] *See* FY 2011, Quarter 3, Revenue, Pieces, and Weight Report, http://www.prc.gov/Docs/74/74925/Fy2011q3_RPWsummaryreport_public.xls.

> **maximize contribution,** not reduce it. [USPS Petitioner's Brief, U.S. Court of Appeals for the D.C. Circuit, No. 11-1117 (Oct. 7, 2011), p. 32-34 (emphasis added).]

The Postal Service's noticed rates for Standard Mail do not appear to be consistent with that goal.

A. Comparing Postal Service Pricing with Alternative Pricing Approach.

Two flat products within Standard Mail — Carrier Route and Standard Flats — consist largely of catalogs. The Postal Service supports its pricing as designed to protect the catalog industry generally from disproportionate pricing increases. Notice, pp. 18-19. That belief is tested by the analysis in this section where we contrast (i) the Postal Service's noticed price increase which gives approximately the same increases to these two products with (ii) a hypothetical Alternative pricing designed to recover the same incremental revenues but which focuses the entire price increase on the Standard Flats product, giving Carrier Route Flats no increase. We then discuss why the Postal Service's own best interest is not advanced by its proposed pricing.

The following analysis is based on the most recent data available — that for FY 2010.[14] Table 1 below shows in designated columns: (i) the revenue from the two products used by flat catalog mailers in FY 2010; (ii) the percentage price increase announced for implementation on January 22, 2012; (iii) the anticipated increase in revenue from those higher prices; (iv) what the percentage price increase would be if the entirety of the target revenue for catalogs had been derived solely from Standard Flats (*i.e.*, no change in the price of Carrier

---

[14] FY 2011 revenue are not yet available, and when those data become available, they will reflect the price increase from Docket No. R2011-2 that took effect April 17, 2011.

Route); and (v) the anticipated increase in revenue that would be achieved using the Alternate prices. This Alternate pricing approach does not reflect the Standard Mail pricing changes urged by Valpak, which are set out in Section II, *supra*, but is only a hypothetical.

Table III-1

Proposed and Alternate Price Increases for Products Used by Catalog Mailers

	(1) 2010 Revenue (mill.)	(2) USPS Percent Price Change	(3) Extra Rev. from USPS Price Change (mill.)	(4) Alternate Percent Price Change	(5) Extra Rev. from Alt. Price Change (mill.)
Carrier Route	$2,223.0	2.425%	$ 53.91	0.000%	$ 00.00
Standard Flats	2,579.4	2.209	56.98	4.299	110.89
TOTAL	$4,802.4		$110.89		$110.89

Sources: Column 1, FY 2010 CRA.
Column 2, Docket No. 2012-3, USPS Notice of Rate Adjustment.

As shown in Table III-1, column 4, under this Alternate adjustment, the price increase on Standard Flats, weighted by FY 2010 revenue, would have been 4.3 percent, instead of 2.2 percent. Comparing columns 3 and 5 of Table III-1, both the USPS price adjustment and the Alternate price adjustment are each seen to provide the Postal Service with the same incremental revenue, hence each can be considered equally compliant with the cap applicable for all Standard Mail.

The Postal Service's 2010 CRA reported:

- a **positive** unit contribution from Carrier Route of **$0.071 (7.1 cents)**, and
- a **negative** unit contribution (loss) from Standard Flats of **-$0.083 (-8.3 cents).**

The Alternate price adjustment discussed here would have two certain effects, both of which are highly desirable. First, it would help alleviate the substantial annual loss incurred by the Standard Flats product. Second, it would send mailers correct price signals vis-a-vis the attributable cost and contribution to overhead made by each product, and thereby provide additional incentive for catalog mailers to find creative ways to increase their use of the profitable Carrier Route product (or even the profitable Standard Letter product), rather than the deeply underwater Standard Flats product.

B. Postal Service Pricing and Alternate Pricing Contrasted.

On prior occasions, the Postal Service and American Catalog Mailers Association ("ACMA") have explained that catalog mailers generally use both of these two products, in varying degrees, as suits the business needs of each individual mailer. *See*, *e.g.*, Docket No. R2011-5, Response of the Postal Service to Chairman's Information Request No. 1, Question 1, and Docket No. R2010-4, ACMA Initial Comments, p. 4. Accordingly, the benefit of the Alternate price adjustment is demonstrated by an example illustrating the effect on catalog mailers with different mailing profiles.

We posit three hypothetical catalog mailers, A, B, and C, each of whom divide their mail between Carrier Route and Standard Flats in varying degrees. Their use of Carrier Route is assumed to be, respectively, 75, 50 and 25 percent. The average unit contribution that the Postal Service derived from each of our three hypothetical mailers in 2010 is shown in Table III-2, below. As can be seen from column 5, the average unit contribution from mailers A, B and C, was, respectively, $0.033, -$0.006, and -$0.045.

Table III-2

Average 2010 Unit Contribution from Three Hypothetical Catalog Mailers

Mailer	(1) Percent Carrier Route	(2) Percent Standard Flats	(3) Carrier-Route Contrib.	(4) Standard Flats Contrib.	(5) Combined Average Contrib.
A	0.75	0.25	0.053	-0.021	0.033
B	0.50	0.50	0.036	-0.042	-0.006
C	0.25	0.75	0.018	-0.062	-0.045

Source: Unit contribution data are from the FY 2010 CRA.

Based on the average contribution by each mailer, the Postal Service would regard mailer A as a profitable customer (from a purely financial perspective, mailer A might be deemed a “good” or “valued” customer). Mailer B was essentially a breakeven customer. Finally, each time mailer C entered catalogs, the costs that the Postal Service was forced to incur on account of that mail were less than the revenue received. Mailer C was a customer who, from the financial perspective of maximizing contribution, the Postal Service conceivably could do without. Without doubt, the Postal Service derives greater financial benefits from those catalog mailers who enter a higher percentage of their mail in the Carrier Route product.

For each of these three hypothetical catalog mailers, we next examine the percentage increase that each mailer would face from the Postal Service increase and the Alternate price increase. (The percentage price increases are in Table III-3, columns 3 and 5.) The Postal Service price adjustment increases the price of Carrier Route by 2.43 percent, slightly more that the 2.21 percent increase for Standard Flats (Table III-3, column 3). Thus, to achieve the target revenue from the two flat products, the Postal Service proposal will cause mailer A (the "good" or "valued" catalog customer) to pay an average increase of 2.35 percent, slightly higher than mailers B and C will be required to pay. In other words, the Postal Service's best catalog customers are hit with a price increase that slightly exceeds the increase given to those catalog mailers who cause the Postal Service to incur losses each time they mail. That is not the way to maximize contribution, both in 2012 and years thereafter, as discussed next.

Table III-3

Average Price Increase, USPS and Alternate

Mailer	(1) 2010 Average Price	(2) USPS 2012 Average Price	(3) USPS Percentage Increase	(4) Alternate 2012 Average Price	(5) Alternate Percentage Increase
A	0.269	0.275	2.35%	0.272	1.46%
B	0.301	0.308	2.29	0.309	2.61
C	0.334	0.341	2.25	0.345	3.54

All price increases can be presumed to have a detrimental effect on mailers. However, the Alternate proposal here will have a less detrimental effect on mailer A, who would be subject to a weighted average 1.46 percent increase, whereas mailers B and C would be faced with average weighted increases of 2.61 and 3.54 percent, respectively. Why the Postal Service elects to **penalize its best catalog customers** with such an increase, while protecting and **nurturing those catalog mailers who are causing it to lose money**, is not explained, nor can it be inferred. However, the Postal Service's pricing is based on its belief that the pricing flexibility under PAEA enables it to compel other Standard mailers to subsidize losses that it thus far has failed to address, and therefore chooses to incur, on the Standard Flats product.

C. The Postal Service Has Not Demonstrated which, If Any, Catalog Mailers Are in Financial Jeopardy.

The Postal Service's filing contains a brief comment on its price adjustments to the two flat products in Standard Mail, but this comment really is directed to the entire catalog industry. No effort is made to explain why a higher price adjustment is imposed on Carrier Route flats than on Standard Flats.

> The Postal Service remains concerned about the financial health and long-term **viability of the catalog industry,** a major user of the Flats product, and so the Postal Service has used its pricing flexibility to keep Flats price increases moderate (objectives 2, 4, factors 3, 7), even though the product's price increase is slightly above the cap (objective 5, factor 2). This approach reflects ongoing concern that the **condition of the catalog industry** and the economy generally **suggest that substantially larger than average Flats price increases may result in volume declines** that may undermine the viability of this product. In addition, potential operational changes, including network optimization, could substantially reduce operating expenditures. Thus, a balanced approach of moderate price increases in conjunction with cost saving will, over time, begin to address the cost challenges faced by this product. [USPS Notice of Pricing Adjustment (Oct. 18, 2011), pp. 18-19 (emphasis added).]

The Postal Service recognizes that catalog volume has been declining for some time, and viability of existing catalog mailers may be threatened by any price increase whatsoever. But, despite the fact that the Postal Service itself is now financially threatened, the Postal Service pricing is solicitous of an intractably and deeply unprofitable product.

Table III-1 demonstrates that the Postal Service seeks to derive an additional $110.89 million from catalog mailers. The Postal Service's narrative assumes that from a financial perspective, some (perhaps all) mailers in the catalog industry are only marginally viable. However, the fact that some mailers enter a higher percentage of their catalogs in Carrier

Route (*e.g.*, mailer A in the example here) should not be perceived as an indication of the relative financial viability of those particular mailers. Other catalog mailers who use mostly Standard Flats (*e.g.*, mailer C) conceivably could have a much higher response rate through judicious targeting of past and potential customers, and be far more viable financially than those who mail a high percentage of Carrier Route mail (*e.g.*, mailer A). Thus, absent explicit evidence to the contrary, the Postal Service should presume that the price increase proposed here could threaten the viability of catalog mailers such as A just as much as, or perhaps even more than, other catalog mailers such as mailer C.

The narrative's fleeting mention of "**potential** operational changes" (Notice, p. 19 (emphasis added)) that, at some point in the future, may "reduce operating expenditures" and result in cost savings only is not only totally unsupported, but also has been repeated so often that it loses any credibility, and is so vague as to evidence a degree of self-delusion. It takes no account of the extended discussion in the recent Periodicals Report, which explained in some detail why flats that do not have sufficient presort to avoid extensive handling are an inherently expensive product.[15]

The Postal Service requires payment in cash, and because credit is not extended, the Postal Service has no current need to know anything about the financial condition of its individual customers, *i.e.*, the Postal Service need not obtain credit reports or financial statements of its customers. In times of financial distress, it is unlikely that the Postal Service has expended large amounts of money doing analysis of catalog mailers' publicly available

---

[15] *See, e.g.,* Periodicals Mail Study: Joint Report of the USPS and PRC (Sept. 2011), Chapter 3.

financials, and of course, any such effort would not address privately owned companies. Therefore, there is no reason to believe that the Postal Service has any detailed information about the financial condition of individual firms in the catalog industry — except, perhaps, for information volunteered by users of Standard Flats in support of their demand for continued underwater pricing and subsidy. Moreover, when adjusting prices, there is no reason to assume that the Postal Service has evaluated the financial viability of catalog mailers based on each one's relative usage of Standard Flats and Carrier Route. Yet the Postal Service has made an unexplained decision to subsidize those catalog mailers who use a product that does not cover its costs, while demanding higher rates than otherwise would be necessary from other Standard Mail users, including catalog mailers who rely heavily on the Carrier Route product.

D. The Postal Service Cannot Afford to Price against Its Own Financial Interest.

As among its many different catalog customers, all the Postal Service needs to know is that **from its own self-interest** — *i.e.*, the financial perspective of **maximizing contribution** — its **best flats customers** are those who use a high percentage of Carrier Route. If the Postal Service cannot perceive this basic distinction, then the Postal Service is indeed in deep trouble. To the extent that higher rates designed to raise $110.89 million must be imposed on catalog mailers, it seems rather clear that the **Postal Service's own financial interest** would be to try to **protect the viability of its best catalog customers** — *i.e.*, those who provide the Postal Service with the greatest unit contribution — **which its pricing adjustments clearly do not do.** Putting it bluntly, if the relatively low price adjustments in this docket are fated to make some catalog mailers financially non-viable (or cause them to withdraw from the mail and rely exclusively on the Internet), better that should happen to those customers who cause the Postal Service to lose money, rather than its best customers, who help it survive. Instead, however, the Postal Service's price adjustments for flats might be said to "spread the necessary financial pain" more or less ratably, with slightly more "pain" doled out to its best catalog customers.[16] In this docket, it again has refused to use its pricing flexibility under PAEA in a manner that would reduce the annual loss on Standard Flats and improve its finances.[17]

As noted at the outset, the Postal Service alleges that it is trying to maximize contribution because of its fiscal crisis, but its pricing decisions consistently signal the contrary, not only in this docket but also in prior price adjustment dockets as well. It persistently **uses its pricing flexibility to perpetuate losses** by favoring those catalog customers who help it lose money, rather than those catalog customers who improve its finances; *see* Table III-4.

---

16 The Postal Service's way of "rewarding" its best customers with above-average price increases stands in sharp contrast to industries such as airlines and hotels, which have designed and implemented programs that systematically identify and reward their best customers with tangible, meaningful benefits.

17 Price increases for the two Standard flat products in Docket No. R2011-2 were even less rational than this docket — with 0.835 percent increase for Standard Flats and a 1.376 percent increase for Carrier Route. *See* Table III-4 for the equally irrational adjustments in Docket Nos. R2008-1 and R2009-2.

Table III-4

Standard Mail and Flats Percentage Price Increase

Docket No.	Flats	Carrier Route	Standard Mail
R2008-1	0.865%	2.995%	2.838%
R2009-2	2.306%	4.310%	3.781%
R2010-4 (rejected)	5.134%	4.919%	5.616%
R2011-2	0.835%	1.376%	1.739%
R2012-3	2.209%	2.425%	2.124%

The Postal Service offers no economic rationale to support such a counterintuitive pricing adjustment for the two flats products used by catalog mailers. In fact, its pricing adjustments give the impression that the Postal Service relishes losing (other mailers') money to nurture those customers who help it lose more than a half billion dollars annually.

Unless and until the Postal Service does a better job of identifying its own best interests and using its pricing flexibility to further those interests in this new hyper-competitive world brought on by the Internet, its future is in doubt.

IV. PERIODICALS PRICING PRESENTS A PERPLEXING PROBLEM FOR THE POSTAL SERVICE.

The Postal Service has noticed a price adjustment for the Periodicals class up to the level of the cap — 2.133 percent. The Postal Service states that it:

> is cognizant of the special situation of Periodicals in terms of both its value to the public (Factor 8, Factor 11), and its failure to cover costs. This price

> change refines price relationships to encourage efficiency and containerization, while limiting the price increases for individual publications. [Notice, p. 23.]

Nonetheless, the Periodicals class will continue to be deeply underwater for the foreseeable future. The Postal Service has been losing money on Periodicals since 1997, and **lost $611 million in FY 2010 alone**. Over the past four Annual Compliance Determinations, the Commission has taken a wait-and-see approach to this problem. *See* Docket No. ACR2010, Valpak Initial Comments, pp. 32-38 and FY 2010 ACD, pp. 16-17, 92-94. Although PAEA unequivocally requires that each class of mail cover its attributable costs, that statute offers no meaningful way to do so unless the Commission finds Periodicals to be not in compliance — an action which it thus far has refused to take despite dutifully reporting the large and growing deficit from the Periodicals class in each year's ACD. As the volume of First-Class Mail declines and the Postal Service's financial insolvency deepens, continued inaction soon may face Congress with the vexing issue of either (i) requiring an above-cap increase in prices for Periodicals, or (ii) using taxpayer money to subsidize Periodicals.

The September 2011 Periodicals Report makes it clear that cost cutting cannot and will not solve the problem. The Report states that the Postal Service found that the range of potential savings from operational changes is $120 million to $146 million per year. Periodicals Report, p. 95. The Commission postulated that handling Periodicals differently could save as much as $349 million annually — a view disputed by the Postal Service. *Id.*, p. 98. Given that the loss for FY 2010 was $611 million, it is clear that, in a best case, operational cost savings alone would move Periodicals only, perhaps, one-half of the way to breakeven. The Periodicals Report admits, "Given the remaining financial gap, even after potential cost savings from operational efficiency improvements are realized, **the focus must shift to** how **the revenue side** of the cost coverage equation can be improved." *Id.*, p. 91 (emphasis added).

Prices proposed for Periodicals are within the price cap and appear to be technically compliant with 39 U.S.C. section 3622(d). Furthermore, the Commission did not order the Postal Service to take any specific action with respect to Periodicals pricing in its FY 2010 ACD. The principal pricing action available within the rate cap would be to increase the passthrough of cost to revenue for those elements in the rate structure that reflect cost-drivers (*e.g.*, the price for sacks, bundles and pallets), as the Commission has urged the Postal Service to consider in previous ACDs. *See, e.g.*, FY 2010 ACD, p. 97. The Postal Service's price adjustments appear to add only minimal incentive "to encourage efficiency and containerization."

Total losses from underwater products exceeded $1,669 million in FY 2010. *See* FY 2010 ACD, p. 29. Certainly, continuing losses on underwater products were not contemplated by PAEA, and in the next Annual Compliance Review, the Commission should review how it needs to respond to those losses. In the meantime, if the magnitude of the Periodicals losses are not addressed by the Commission, it makes it even more imperative that the Postal Service not incur losses on other products — such as **Standard Flats**, discussed in Sections II-III, *supra*.

V. Timing of Price Adjustments.

In previous dockets, Valpak has raised the issue of the timing of (i) the Postal Service's market dominant price adjustment, with relation to (ii) the Commission's the annual compliance review. *See, e.g.*, Docket No. ACR2009, Valpak Initial Comments; Docket No. R2011-2, Valpak Comments. The Postal Service's current proposed price adjustment uses a mid-January implementation date. Moreover, simultaneous with its Notice, the Postal Service filed its Updated Schedule of Regular and Predictable Price Changes, stating that it expects to file subsequent market dominant price changes in January of each year using the available cap authority.

From the standpoint of mailer participation, the timing of the current Notice is improved over the last price adjustment (Docket No. R2011-2) where participant Comments were due on the same day as Initial Comments in Docket No. ACR2010.

However, from the more important standpoint of the Postal Service pricing changes reflecting the Commission's guidance in its annual compliance reviews, it is better than some other dates, but not optimal. The Commission's last ACD was issued in March 2011, and with a January 2012 implementation date, the Commission's recommendations at the earliest can be reflected in price changes nine months after the ACD is issued. However, Valpak is fully cognizant that PAEA allows the Postal Service full discretion regarding the implementation of a price adjustment, and there are many factors involved.

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc.,
and Valpak Dealers' Association, Inc.